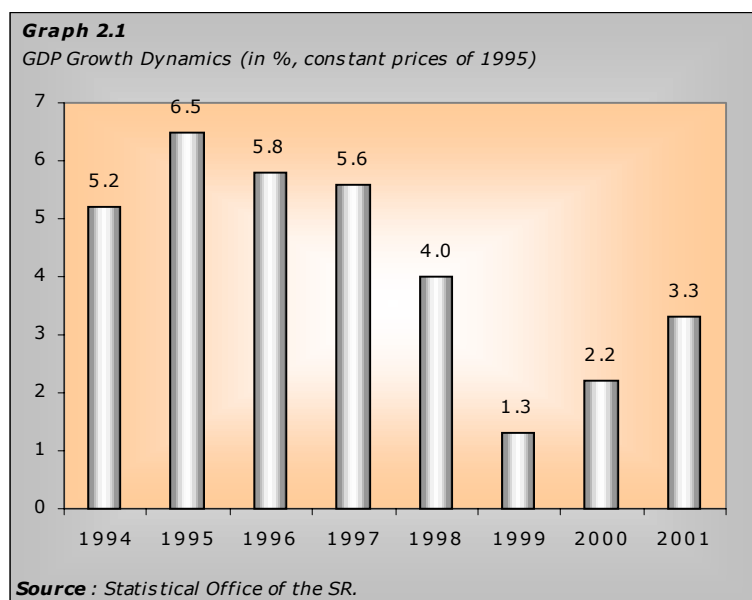


## 2.2 ECONOMIC DEVELOPMENT AND THE LABOR MARKET

Since 2000 the development of Slovakia's economy has been characterized by the efforts of the government and the Central bank to stabilize macroeconomic factors in order to gradually bring about a recovery of the economic growth dynamics. As a positive stimulus and confirmation of progress achieved in this area, Slovakia was admitted to the Organisation for Economic Cooperation and Development (OECD) on December 14, 2000. At the end of 2001, based on favorable economic development, Moody's Investor Service and Standard & Poor's improved their rating outlook to positive and increased Slovakia's rating, returning it to investment level. However, Slovakia's economic development still remains branded by structural problems in foreign trade, public finance sectors, and labor market.

### 2.2.1 Performance of the Economy

Between 2000 and 2001, gross domestic product (GDP) witnessed favorable development (Graph 2.1). Macroeconomic stabilization displayed slight GDP growth in 2000 (2.2 percent) and suppression of domestic demand, resulting in short-term improvement of external disbalance of Slovakia's economy. The upward trend of the GDP continued in 2001 (3.3 percent).



In 2000, the major determinant of the real GDP growth was due to foreign trade growth. In 2001, due to successful privatization and restructuring of the banking sector and partial restructuring of the private sector, the most dynamic GDP component were domestic investments with a year on year increase of 9.6 percent (generation of gross fixed capital, see Table 2.1). On the one hand, this trend was caused by a pronounced increase in foreign direct investments (the year on year FDI increment reached 83 percent and 28 percent in 2000 and 2001, respectively<sup>18</sup>); on the other hand, it supported demand for investments by domestic companies, thus imports of machines and equipment went up. The growth of domestic consumption in that year was also supported by the State which, despite the declared restrictive position, actually increased its consumption by 5.1 percent, thus making a contribution of about 1 percent to the growth of the economy.

<sup>18</sup> As at end of the respective year. Source: National Bank of Slovakia.

**Table 2.1***GDP Structure (1999-2001)*

<b>Indicator (in constant prices of 1995, SKK billion)</b>	<b>1999</b>	<b>% of GDP</b>	<b>2000</b>	<b>% of GDP</b>	<b>2001</b>	<b>% of GDP</b>
GDP	670.0		684.8	-	707.3	
<i>year-on-year change (%)</i>	<i>1.3</i>		<i>2.2</i>		<i>3.3</i>	
Consumption of households	361.2	53.9	354.6	51.8	368.9	52.2
<i>year-on-year change (%)</i>	<i>2.9</i>		<i>-1.8</i>		<i>4.0</i>	
Consumption of nonprofit entities	6.3	0.9	6.2	0.9	6.0	0.8
<i>year-on-year change (%)</i>	<i>35.0</i>		<i>1.5</i>		<i>3.4</i>	
Consumption of State	135.8	20.3	137.5	20.0	144.5	20.4
<i>Year-on-year change (%)</i>	<i>-7.7</i>		<i>1.3</i>		<i>5.1</i>	
Generation of gross fixed capital	193.7	28.9	196.1	29.0	214.8	30.4
<i>Year-on-year change (%)</i>	<i>-18.5</i>		<i>1.2</i>		<i>9.6</i>	
Export	456.3	68.1	519.2	75.8	552.8	78.2
<i>Year-on-year change (%)</i>	<i>5.2</i>		<i>13.8</i>		<i>6.5</i>	
Import	472.5	70.5	520.8	76.0	581.5	82.2
<i>Year-on-year change (%)</i>	<i>-6.3</i>		<i>10.2</i>		<i>11.7</i>	

**Source:** Selected Indicators of Economic Development in the SR 1991-2001 Statistical Office of the SR (2002).

## 2.2.2 Price Development

The inflation rate kept decreasing throughout the period monitored. The dynamics of consumer prices within 2000-2001 were mostly influenced by the government's decision to release the regulated prices of electricity, gas, and water for households and industrial customers. High prices for energy raw materials (oil and gas) as well as food prices added to these pro-inflationary factors during the first half of 2001. Oil prices, however, dropped during the second half of the same year, pushing (together with a slight appreciation of the domestic currency) the domestic level of non-regulated prices (i.e., core inflation<sup>19</sup>) to the year-on-year level of 4.3 percent, thus markedly below the currency expectations of the central bank. Food prices grew due to the poor harvest in 2000, and ignored seasonal development during the first half of 2001 (foods and soft drinks increased by about 7 percent in 2001 compared to 2000<sup>20</sup>). Despite the aforementioned factors, the overall inflation rate kept decreasing, reaching yearly average values of 12 percent and 7.3 percent in 2000 and 2001, respectively (see Graphs 2.4 and 2.5).

## 2.2.3 Foreign Trade and Currency

The gradual decrease of the domestic price level and the recovery of the economy also manifested themselves with respect to the year on year growth of real wages, which – together with the amortization, in 2001, of the privatization bonds of the National Property Fund (SKK 30 billion, about 3 percent of GDP)<sup>21</sup> – markedly influenced growing domestic demand.<sup>22</sup> Linked with the growth of oil prices in world markets, in the view of the unilateral dependence of the country's economy on imports of strategic energy raw materials, it intensified the foreign trade deficit towards the end of 2000 and during 2001. The period of stabilization was replaced by a period of a record deficit of the current account of the balance of payment, reaching about 8.8 percent GDP in 2001.<sup>23</sup>

<sup>19</sup> Core inflation measures the price level increase of a consumption basket net of state-regulated prices.

<sup>20</sup> In constant prices of 1995.

<sup>21</sup> According to analysts, about one half of the amount mentioned was spent on household consumption in the second half of 2001.

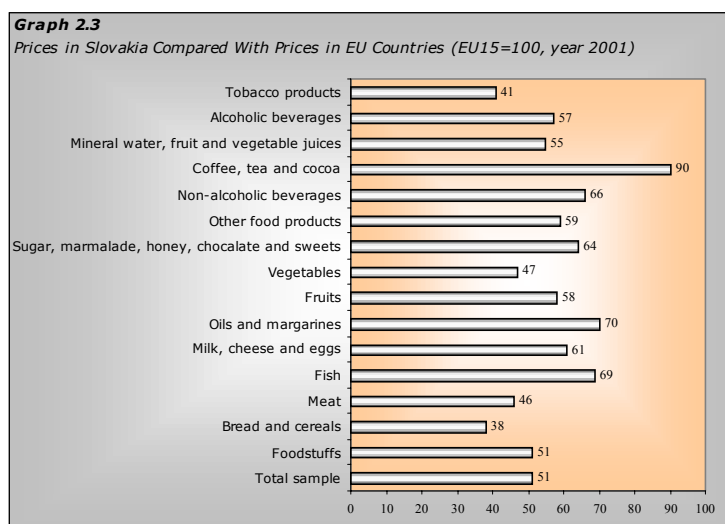
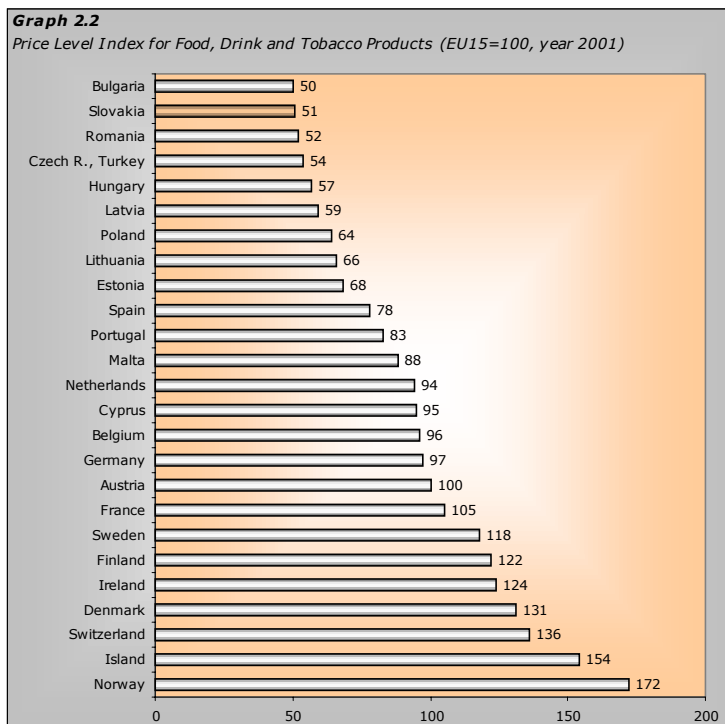
<sup>22</sup> More than 3.3 million individuals registered for the second wave of voucher privatization in 1994. V. Mečiar's government abolished the second wave in 1995, and the registered owners of voucher booklets received non-tradable bonds worth about SKK 10,000.

<sup>23</sup> The deficit level thus approaches the figures from the unquiet years between 1996 and 1998, which witnessed a marked fall of the Slovak currency and the decrease of the rating of the country. However, in the face of a markedly higher inflow of FDI

**Box 2.1***Slovaks Spend One-Third of Their Income on Food and Drink*

Even though food prices have risen almost 30 percent since 1995, they are still among the lowest ones in Europe, as suggested by a recently published comparative Eurostat survey. Slovak households spend on average 32 to 34 percent of their net financial income on purchases of basic food and drink, which is the highest proportion among all the OECD member states. In addition, this proportion is differentiated in dependence upon the social group. According to official 2001 data from the Statistical Office of the Slovak Republic, farmers, employees, self-employed persons, and pensioners spent 25.8 percent, 25.2 percent, 25.3 percent, and as much as 36.2 percent of their monthly expenditures on consumption of food, respectively.

In cooperation with OECD, Eurostat collected in the spring of 2001 data about prices of 550 comparable goods from 31 European countries. Based on this sample, Eurostat construed the so-called Price Level Index (PLI) for selected food, drink, and tobacco products. This parameter was calculated as the ratio of Purchasing Power Parity (PPP) to the exchange rate of the corresponding country, and can subsequently be compared with, e.g., the average value calculated for the European Union. Values above 100 suggest that the selected goods are relatively more expensive in the given country than the EU average, and vice versa. *Source: Eurostat (2002).*

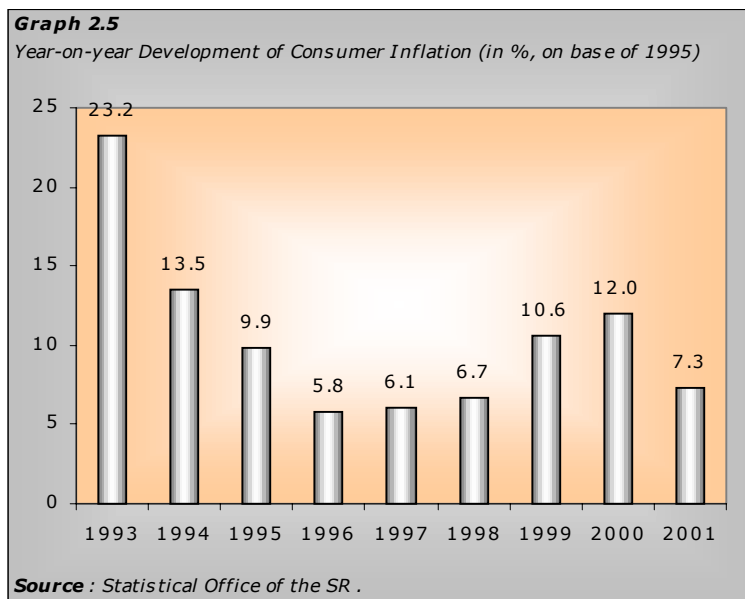
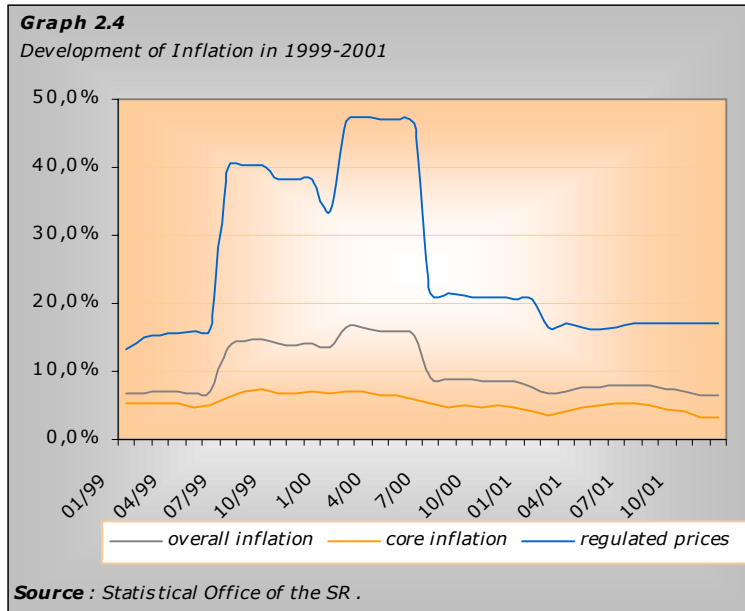


In the opinion of several analysts, this development suggests that the so-called package of measures of 1999<sup>24</sup> only had a short-term effect upon the development of foreign trade; the growth of

(which, in 2001, exceeded the volume of the deficit of the current account almost three times, and covered more than four-fifths in 2001), the risk of financial destabilization of Slovakia is significantly smaller as compared to the said period of time.

<sup>24</sup> For details, see National Human Development Report Slovak Republic 1999 (1999) or Norway (2002).

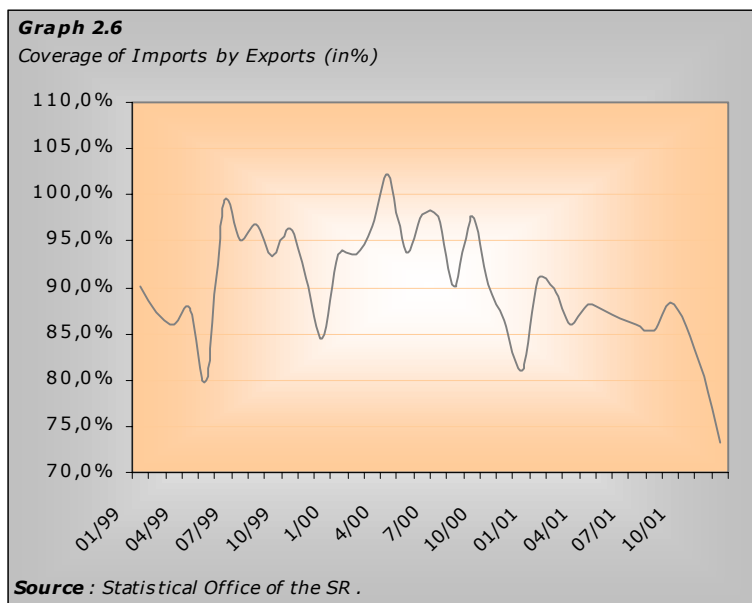
unemployment and the pointing of problems which mainly small and medium enterprises oriented towards the domestic market were suffering from, had a more significant impact. On the other hand, it may be stated that the "deficit of the current account reflects the restructuring of Slovakia's economy through a pronounced inflow of FDI and imports of capital goods. The resulting modernization of the domestic capital stock represents a positive factor of convergence with EU countries".<sup>25</sup>



The development of the Slovak currency within 2000 and 2001 can be viewed as stabilized. In the first half of 2000, due to the restrictive policy of the government and the central bank, appropriate macroeconomic conditions were established to appreciate the domestic currency against the reference EUR. During the said period, domestic currency strengthened to reach a historical maximum of SKK 41.170/EUR. The development in the world foreign exchange markets during the monitored period, however, brought an additional drop of EUR against the US dollar, which subsequently became reflected in a sudden growth of the US dollar-Slovak crown exchange rate. Later on, the development of the Slovak currency was mostly influenced by domestic political events, including the resignation of B. Schmögnerová as the Minister of Finance, the dramatic illness of President R. Schuster, or the opening referendum on pre-term parliamentary elections in late 2000. In 2001, however, the Slovak currency

<sup>25</sup> Source: OECD Economic Surveys: Slovak Republic, pp. 31-32.

gradually appreciated against the EUR; its exchange rate being positively influenced by the aforementioned improvement of Slovakia's international investment ratings.



## 2.2.4 Public Finances

The State Budget recorded deficits over the last two years. In 2000, the deficit reached SKK 27.7 bn (i.e., 3.1 percent of GDP), growing to as much as SKK 44.4 bn (about 4.6 percent of GDP) a year later.<sup>26</sup> Even though it failed to meet its pre-accession plan to reduce the deficit below the 3 percent GDP level within 2000-2001, the government succeeded in achieving some improvements in this respect. The tax-related burden on individuals and companies could be reduced without a significant decrease in tax revenues. Public administration reform was launched; it is expected to result in more decentralized public financing and democratization of decision making.<sup>27</sup> As one of the reform steps implemented towards making the system of public finances more efficient, it was decided to abolish the majority of state funds, effective January 1, 2002 (with the exception of State Housing Development Fund<sup>28</sup> and State Nuclear Energy Installations and Spent Nuclear Fuels and Radioactive Waste Management Fund). Social security and health care system have become the agenda of the day.

As of the end of 2001, the official State debt reached the volume of SKK 365.8 bn, representing some 39.7 percent of GDP. With the volume of State guarantees included, the total State debt to GDP ratio makes up as much as 54 percent, still in compliance with the corresponding Maastricht criterion with respect in the European Monetary Union membership. According to this criterion, the overall indebtedness of the public sector must not exceed 60 percent GDP. Among the priorities of the Slovak Government during this election term, the recovery of the banking sector was mentioned; the State spent SKK 180 bn on restructuring of the sector.<sup>29</sup>

## 2.2.5 Labor Market and Social Situation

In recent years, the Slovak labor market has been dominated by relatively pronounced trends; growing numbers of economically active population, stagnating employment, and high and regionally differing unemployment rates. About one-fifth of the labor force is officially registered as unemployed, which in statistical terms means that virtually one in four Slovak households has an adult member officially receiving no income from employment. Table 2.2 illustrates the development of the principal labor market parameters during the last five years.

<sup>26</sup> Using the ESA 95 methodology, the state budget deficit reached 6.5 percent and 5.9 percent as a share on GDP in 2000 and 2001, respectively. For details, see Tóth (2002).

<sup>27</sup> The first elections for self-governing bodies took place in 2001 (so-called higher-tier territorial units, regional parliaments).

<sup>28</sup> Scheduled to become abolished on January 1, 2003.

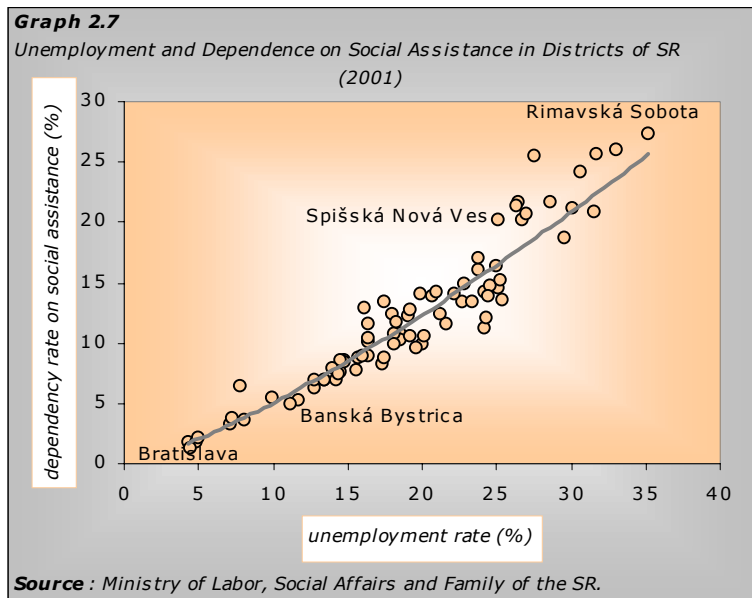
<sup>29</sup> These costs include the payoff of the principal of SKK 102 bn, estimated interest of SKK 56.59 bn, and costs of increasing equity of SKK 18.9 bn.

**Table 2.2***Development of Labor Market Parameters, by Regions (numbers in ,000 persons, rates in percent)*

Region	Indicator	Year				
		1997	1998	1999	2000	2001
Bratislavský	Economically active population	325.1	331.1	335.8	337.2	337.4
	of which					
	Employed/self-employed	304.1	308.6	309.2	310.8	308.3
	Unemployed	18.5	20.0	24.6	24.4	28.2
	Economic activity rate	64.7	65.2	65.6	65.4	64.8
	Employment rate	60.5	60.8	60.4	60.3	59.2
	<b>Unemployment rate</b>	<b>5.7</b>	<b>6.0</b>	<b>7.4</b>	<b>7.2</b>	<b>8.3</b>
Trnavský	Economically active population	260.1	260.2	266.5	273.0	286.0
	of which					
	Employed/self-employed	230.0	226.3	229.8	225.0	232.4
	Unemployed	28.8	30.7	32.8	44.7	51.5
	Economic activity rate	59.7	59.1	59.9	60.9	63.2
	Employment rate	52.8	51.4	51.7	50.2	51.4
	<b>Unemployment rate</b>	<b>11.1</b>	<b>11.8</b>	<b>12.3</b>	<b>16.4</b>	<b>18.0</b>
Trenčiansky	Economically active population	285.9	297.9	288.4	294.1	296.7
	of which					
	Employed/self-employed	259.6	270.7	252.4	247.8	254.0
	Unemployed	25.4	23.0	32.9	44.2	39.8
	Economic activity rate	59.4	61.3	58.9	59.6	59.6
	Employment rate	53.9	55.7	51.5	50.2	51.0
	<b>Unemployment rate</b>	<b>8.9</b>	<b>7.7</b>	<b>11.4</b>	<b>15.0</b>	<b>13.4</b>
Nitriansky	Economically active population	332.7	329.3	328.2	335.3	343.1
	of which					
	Employed/self-employed	279.4	285.2	266.9	263.3	261.7
	Unemployed	50.6	39.9	58.3	69.8	79.4
	Economic activity rate	57.9	56.9	56.4	57.2	58.2
	Employment rate	48.6	49.3	45.8	44.9	44.4
	<b>Unemployment rate</b>	<b>15.2</b>	<b>12.1</b>	<b>17.8</b>	<b>20.8</b>	<b>23.1</b>
Žilinský	Economically active population	326.2	332.5	332.3	332.1	334.9
	of which					
	Employed/self-employed	294.7	292.9	275.1	266.7	267.6
	Unemployed	27.5	34.8	52.6	61.4	63.3
	Economic activity rate	61.6	62.1	61.5	60.9	60.8
	Employment rate	55.6	54.7	50.9	48.9	48.6
	<b>Unemployment rate</b>	<b>8.4</b>	<b>10.5</b>	<b>15.9</b>	<b>18.5</b>	<b>18.9</b>
Banskobystrický	Economically active population	307.7	308.3	313.8	317.4	327.6
	of which					
	Employed/self-employed	262.7	257.4	246.2	245.7	251.2
	Unemployed	42.8	48.2	66.3	69.6	73.4
	Economic activity rate	58.5	58.2	58.9	59.2	60.7
	Employment rate	49.9	48.6	46.2	45.8	46.5
	<b>Unemployment rate</b>	<b>13.9</b>	<b>15.6</b>	<b>21.1</b>	<b>21.9</b>	<b>22.4</b>
Prešovský	Economically active population	338.5	342.5	357.7	362.4	366.2
	of which					
	Employed/self-employed	284.6	282.4	285.9	278.4	279.7
	Unemployed	51.0	56.2	68.3	80.1	83.1
	Economic activity rate	58.7	58.6	60.5	60.5	60.4
	Employment rate	49.4	48.3	48.4	46.5	46.1
	<b>Unemployment rate</b>	<b>15.1</b>	<b>16.4</b>	<b>19.1</b>	<b>22.1</b>	<b>22.7</b>
Košícký	Economically active population	346.0	343.1	350.5	356.7	360.6
	of which					
	Employed/self-employed	291.0	275.2	266.9	264.1	268.8
	Unemployed	53.0	64.3	81.0	91.2	89.3
	Economic activity rate	59.0	58.0	58.7	59.2	59.2
	Employment rate	49.7	46.5	44.6	43.8	44.1
	<b>Unemployment rate</b>	<b>15.3</b>	<b>18.7</b>	<b>23.1</b>	<b>25.6</b>	<b>24.8</b>

**Source:** Labor Force Survey. Statistical Office of the SR.

Corresponding with the regional distribution of unemployment are also numbers of individuals in need of social assistance. In recent years, the unemployed account for approximately 90 percent of recipients of social assistance benefits in material distress, with most persons at risk of material distress, which is a certain parallel to material poverty, in regions with the highest unemployment rates (Graph 2.7). The regional differences are even more pronounced at the lower tier, e.g., between districts. There were 11.7 percent of Slovakia's population in material need in 2001.<sup>30</sup>



Despite its long history, poverty in Slovakia still remains a new policy issue. Even if definitions and policies are missing and poverty indices are unsatisfactorily monitored, the development of the main factors, in particular unemployment rates, would suggest that poverty in Slovakia has grown since 1996.<sup>31</sup> However, awareness is also growing in Slovakia that poverty and social exclusion are not only consequences of insufficient or missing income but that they result from effects of multiple factors reflecting dimensions such as education, health, housing, social contacts, etc. The development of several parameters concerning these areas has been on the other hand positive. The basic human development indicators show evidence of this.

A World Bank report from 2001 confirmed that the extent of absolute poverty in Slovakia bears comparison with the best performing transition countries. However, the share of inhabitants living at extremely low-income levels is substantially higher compared with neighboring countries. The analyses speak about deep pockets of poverty in the midst of a relatively well-off population.<sup>32</sup> These pockets or islands of poverty are thought to significantly overlap with isolated and segregated Roma colonies. Estimates suggest that they are the home of about one-third of the Roma population.<sup>33</sup> Due to cumulated handicaps, long-term and permanent unemployment among the Roma is rather widespread, and isolation from the labor market is then transferred to the following generations. Table 2.3 illustrates the high unemployment rates of the Roma compared to the other ethnic groups in Slovakia.

<sup>30</sup> Recipients of social assistance benefits, including dependents.

<sup>31</sup> Reliable data, which may be used to document the income situation of households, are collected at long and irregular intervals. The last Microcensus was undertaken in 1996, preventing a more updated analysis.

<sup>32</sup> For details see World Bank (2001).

<sup>33</sup> Source: Vašečka (2001). In the 2001 population and housing census, 89,920 inhabitants claimed Roma nationality, which equals 1.7 percent of Slovakia's population.

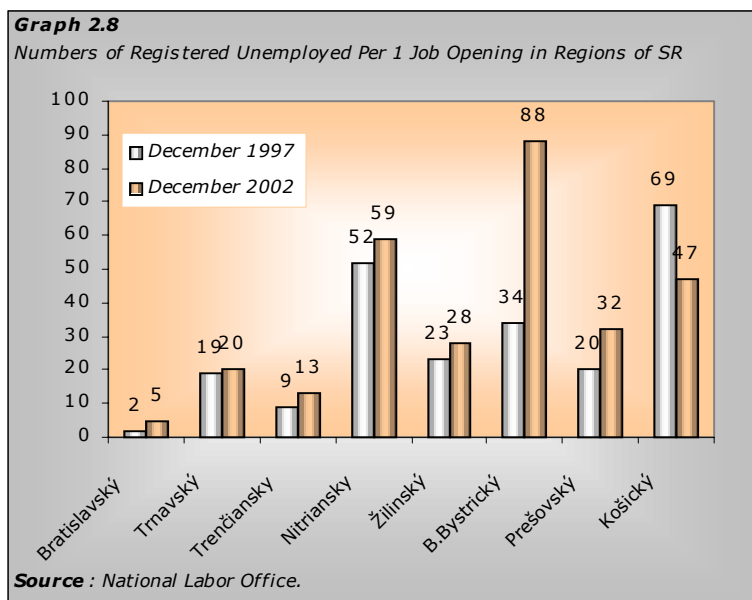
**Table 2.3***Unemployment Rate by Ethnic Groups (age group 15-64 years, in percent)*

Indicators	1998	1999	2000	2001
Total	12.5	16.2	18.6	19.2
Slovak	10.9	14.9	17.5	17.9
Czech	7.6	11.5	13.3	23.9
Hungarian	18.1	22.4	25.5	27.1
German	11.4	-	-	-
Polish	2.0	5.5	23.9	19.9
Russian, Ukrainian, Ruthenian	15.1	21.6	22.0	17.6
Roma	83.2	77.5	73.5	72.6
Moravian	11.6	20.0	-	-
Other	8.1	17.5	2.4	16.5

**Source:** Labor Force Survey. Statistical Office of the SR.

Statistical figures suggest that there is a shortage of official jobs in Slovakia (see Graph 2.8). As stated in the last National Report, in an economy that indicates low generation of job opportunities, the demographic growth of the productive population component will show as growth of unemployment. The demographic development itself, however, cannot be considered the reason for high unemployment. Similar demographic trends namely prevail in a majority of developed countries whose economies, however, are able to cope with this development in the labor market.<sup>34</sup> Unemployment (and thus also shortage of jobs) is a consequence of a whole complex of problems. Most experts agree that the major reasons include:

- ❑ inefficient social protection system (relatively generous and not overly motivating, with significant redistribution of sources and solidarity, with prevailingly passive measures);
- ❑ insufficient education of a portion of the labor force and weak linkage between education and labor market;
- ❑ barriers on the part of the business environment (rigid labor law, instable legislation, low law enforcement, high tax and mainly payroll burden);
- ❑ low mobility of labor and inflexible housing market;
- ❑ other (e.g., passivity, tolerance of shadow activities)



Unemployment remains evidently the weakest point of the socio-economic development in Slovakia and the most sensitive social problem (see Table 1.1). Except for rather occasional cases connected with bankruptcies of enterprises and massive layoffs of employees, high unemployment rates are no reason for serious social unrest to develop in the country. It may be assumed that high incidence of shadow

<sup>34</sup> In many countries the demographic trends result in a decrease of the labor force and these countries import labor force from abroad.



labor is one of the reasons.<sup>35</sup> Domestic estimates of the extent of shadow labor rather differ (ranging from one-tenth up to one-third of the registered unemployed); a foreign source may offer a detached view. Rather surprisingly, Table 2.4 suggests that the size of shadow (gray) labor and economy in Slovakia is among the lowest ones in Central and Eastern European countries.

**Table 2.4**

*The Size of Shadow Economy in Transition Countries*

Country	Size of shadow economy (% of GDP), DYMIMIC method		Shadow economy labor force (% of working age population, 1998/1999) <sup>a</sup>
	Average for 1990-1993	Average for 2000-2001	
Bulgaria	27,1	36,4	30,4
Czech Republic	13,1	18,4	12,6
Estonia	34,3	39,1	33,4
Hungary	22,3	24,4	20,9
Latvia	25,7	39,6	29,6
Lithuania	26,0	29,4	20,3
Poland	22,3	27,4	20,9
Romania	27,3	33,4	24,3
Slovakia	15,1	18,3	16,3
Slovenia	22,9	26,7	21,6

**Note:** a. Working age population means population between the age of 16 and 65.

**Source:** Schneider, F.: *The size and development of the shadow economies of the 22 Transition and 21 OECD countries*. Bonn: IZA, (2002) in: *Study on the Social Protection Systems in the 13 Applicant Countries*. Synthesis report, Second draft. GVG, Köln (2002).

Unemployment is not a phenomenon that would show substantial gender disparity. The gender differences in the proportions of the unemployed are but minimal, with unemployment rates tending to be slightly higher for males than females in recent years, and with women on the contrary slightly prevailing among the long-term unemployed. Available records suggest that unqualified labor faces problems in the labor market regardless of gender. Employment and remuneration show a significant disbalance when it comes to the gender aspect. In 2001, women received on the average three quarters of the average wages of men (see Table 2.5).<sup>36</sup>

**Table 2.5**

*Gender Differences in Remuneration (average wages for females as percentages of average wages for males in the Slovak economy)*

Indicator	1997	1998	1999	2000	2001
Female wage as % of male wage	78.5	77.0	75.0	75.0	75.0

**Source:** Statistical Office of the SR.

The growth of long-term unemployment is also among the marked features of the labor market, along with high unemployment among the young, and marked regional differences. The share of long-term unemployed jobless for 12 or more months reached 57.8 percent of all unemployed towards the end of 2001. The average 2001 unemployment rate among the young people aged 15-24 years was almost twice (37.3 percent) that for the overall population (19.2 percent). Differences in unemployment rates between the individual districts of the Slovak Republic ranged around 30 percent, with the lowest unemployment rate being traditionally recorded for the five districts of Bratislava (3.7 percent-6.2 percent, December 2001) and the highest for the district of Rimavská Sobota (35.5 percent).<sup>37</sup>

The high unemployment rates are associated with significant economic and social costs. Exclusion from the labor market is generally viewed as the most serious form of social exclusion. Addressing the unemployment issue is connected with the overall positive development of the economy; it, however, also requires the undertaking of specific steps in the above areas that were defined as the main reasons. Some of the measures have been included in the agenda of the new government coalition (social assistance, labor legislation). Evidently, unemployment cannot be addressed by labor market policies

<sup>35</sup> Shadow labor also distorts data on the numbers of the population living in poverty or being at risk of poverty. It substitutes official earnings from employment, however to the detriment of all who work and pay taxes and social security contributions.

<sup>36</sup> Discussion on the reasons for the gender income gap as well as for the prevalence of women in low-income sectors and their smaller participation in leading positions was one of the key topics of the 2000 National Human Development Report for Slovakia.

<sup>37</sup> Source: Study on the Social Protection Systems (2002a).

only. Job positions are – and should be – created above all within the private sector, which is the biggest generator of resources. Consequently, key measures are those which will improve the business environment. In addition, significant will be stimuli in the area of education that should not remain without closer contacts with what is happening in the labor market. The biggest challenge will probably be the reorganization of the social protection system, which will have to respect the economic, social and demographic reality. The social system thus needs a tighter link between what is being contributed to the system and what is being retrieved from it. This does not mean necessarily weakening of social solidarity, but it does certainly mean strengthening of the targeted nature of it, to become aimed at those who objectively need it. The reform of the social system therefore must bring about a strengthening of the motivation of individuals to actively deal with their situation in the labor market. In this respect, also the gradual devolution of the responsibility and competencies to regions can be expected to become a supporting factor. Solution to the problem of unemployment is key to the solution to the associated problems of human development, above all of poverty and social exclusion, but eventually also to improvements in public health.